7:00's Report

"Everything you need to know about the markets by 7a.m. each morning, in 7 minutes or less."™

December 26th, 2013

Pre 7:00 Look

- Futures are drifting slightly higher in quiet trading. With most major Western markets closed for Christmas and Boxing Day (today), most of the o/n action came from Asia.
- Japanese shares traded to a 6 year, and the yen hit a new multi year low, after the minutes from the latest BOJ meeting further implied we will see more stimulus in 2014.
- The cash crunch in China continued to ease as repo rates dropped, but the Shanghai market fell after 2013 GDP growth was estimated at 7.6%, slightly below estimates.
- Econ Today: Jobless Claims (E: 340K).

Market	Level	Change	% Change
S&P 500 Futures	1832.75	3.75	.21%
U.S. Dollar (DXY)	80.665	-.009	-.01%
Gold	1206.20	2.90	.24%
WTI	99.26	.04	.04%
10 Year	2.98%	.054	1.84%

Equities

Stocks drifted to new all time highs (again) Tuesday during a very quiet and boring pre-Christmas trading session. The S&P 500 rose .25%.

The "catalyst" for the rally Tuesday (and it's a stretch to name a catalyst, as much of Tuesday's rally was random trading noise) was the strong economic data. Futures got a boost pre-open thanks to the strong Durables report, and New Home Sales helped push the market to the high of the day when it hit at 10 AM.

After the New Home Sales data hit, stocks meandered

Trading was quiet in most markets on Wednesday, but the 10 year yield made a new high for the year.

for the remaining three hours of trading, and closed basically on the highs.

From a trading color standpoint, there's wasn't a whole lot of insight to glean from the half day Tuesday. Generally, we did see continuation of "macro" outperformance and "bond proxy" and "safety" underperformance, which makes sense given the rise in yields Tuesday (I cover it later, but the uptick in bond yields was the most important thing that happened Tuesday).

Industrials, tech and financials broadly outperformed, although there weren't any specific catalysts to account for the outperformance, while REITs, consumer staples and healthcare continued to lag.

Although volumes were predictably low Tuesday, I wanted to point out that even on a slow day, the rotation out of the "bond proxy" stocks into more cyclical sectors remains the most discernable trend in the markets right now, and it likely will continue as long as bond yields continue to move higher, and obviously I think they will for some time to come.

I keep pointing this out because if you have clients who

Market	Level	Change	% Change
Dow	16357.55	62.94	.39%
TSX	13518.02	70.32	.52%
Brazil	51356.10	170.36	.33%
FTSE	6694.17	15.56	.23%
Nikkei	16174.44	164.45	1.03%
Hang Seng	23179.55	257.99	1.13%
ASX	5327.20	35.25	.67%

Prices taken at previous day market close.

are positioned too defensively in some of these "Bond proxy" sectors, there is still plenty of time to get them more exposed to cyclical sectors (meaning this trend is something I think will have legs for a long time to come).

Market	Level	Change	% Change
Gold	1205.70	2.40	.20%
Silver	19.515	.03	.16%
Copper	3.37	.001	.01%
WTI	99.18	-.04	-.04%
Brent	110.56	.09	.08%
Nat Gas	4.46	.04	.93%
Corn	4.35	.075	.17%
Wheat	6.06	0.00	0.0%
Soybean	13.34	.02	.02%

Prices taken at previous day market close.

On the charts the S&P 500 hit another new high, while support remains at 1813.

Bottom Line

The market narrative remains largely unchanged. Stocks continue to grind higher into year end, but really all managers want is for the year to end with no major incidents (protecting performance, not chasing returns, remains the #1 priority of money managers right now).

Bond yields are creeping steadily higher, but as long as economic data continues to improve and the increase in yields doesn't accelerate too much, the path of least resistance for stocks remains higher.

That said, the two "strongest" trends in the markets right now remain that of 1) Higher Japanese stock prices (long DXJ) and 2) Lower bond prices, (long TBT/TBF). Both trades have had huge moves this year and I know I'm not pointing anything out that I haven't done many times before—but neither of these trends are over, by a long shot. Point being, you haven't missed either if you're not yet involved.

Economics

Durable Goods Orders

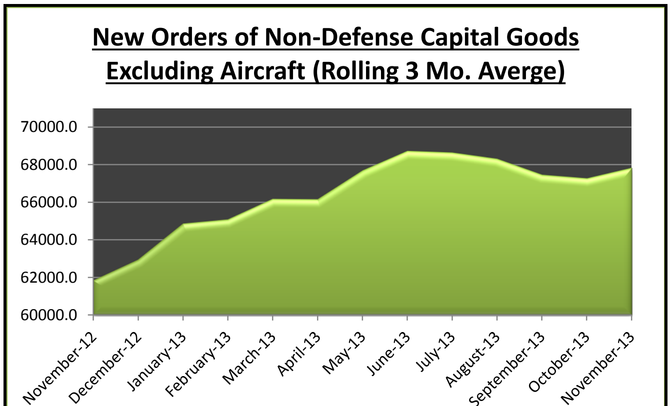
- New Orders for November rose 3.5% vs. (E) 1.5%.
- New Orders for Non-Defense Capital Goods Ex-Aircraft (NDCGXA) jumped 4.5% in November.

Takeaway

The Durable Goods Report released by the Census Bureau on Tuesday showed a solid increase as the headline New Orders number increased by 3.5% month-over-month and an impressive 10.9% year-over-year. Also positively, the October data saw an upward revision, to -0.7% from the initial reading of -2.0%.

New Orders for Non-Defense Capital Goods Ex-Aircraft (NDCGXA), which is really the most-important number in the report because it gives the clearest reading on business spending, increased sharply by 4.5% after falling 3 of the last 4 months.

The move in NDCGXA confirms the strong headline in Durable Goods orders and supports other strong November data (Industrial Production, specifically). And, it'll increase the odds that Q4 GDP will be a bit better than is currently expected. (Durable Goods orders are a proxy for Non-Residential Fixed Investment, one of the major components of GDP.)



The 3 month average for new orders of non-defense capital good ex-aircraft has turned positive, implying business spending and investment may be accelerating in Q4. That's bullish for industrials and increases the chances of an upward surprise in Q4 GDP.

New Home Sales

- November New Home Sales were 464K (saar) vs. (E) 450K.

Takeaway

The November New Home Sales headline number showed a decrease of 2.1% vs. October, implying further weakness in the housing market. But, the headline was very misleading because of a simply massive revision to the October data.

October New Home Sales were revised to 474K (seasonally adjusted annual rate) from the initial reading of 354K, or more than 30% higher!

The November headline indicated that there were 464K new home sales last month, which was well-above analysts' expectations of 450K but below the revised October data. (The initial reading for October was 354K, which was revised to 474K—a difference of 34%.) The October number is now the highest reading since July 2008. Also indicating a strengthening housing market was a dip in inventories, down to 4.3 months of supply from 4.5 in October. Inventories now stand at 167K. The jump in prices is accompanied by an appropriate boost to new home prices, which surged 4.5% M/M. The median home price is now $270,900, up 10.6% Y/Y.

Based on both the October revision and the November headline in new home sales data, the housing market is picking up steam. Of course, it remains to be seen whether this can continue, as rates have again started to move higher (remember rates dipped in September/October, so the December data will be closely watched).

Commodities

Predictably, it was a quiet day in the commodity markets Tuesday, as most major commodities simply drifted around (almost every commodity closed with less than a 1% change).

There were two exceptions, however. The first was natural gas, which fell 1% mostly on light profit-taking and thin trading ahead of tomorrow morning's inventory report.

The second exception was copper, which rallied 1.8% to finish at a four-month high (and intraday copper prices hit a nine-month high, trading above $3.40 for the first time since May).

Copper very quietly has been rallying the entire month of December. Some of that is seasonality, as demand tends to spike early in the new year and supply becomes slightly constrained. But, copper is also confirming several other indicators that imply we are seeing an uptick in global economic activity. The Baltic Dry Index is just off the highs for the year, implying an increase in demand for goods moved via container ships, and global factory output has risen to a multi-month high.

While these indicators are volatile, they are positive for the "global reflation trade" I keep talking about. If they can continue this upward momentum, then the industrial miners, shippers and Australia (and, dare I say it, China) should see an higher prices going forward.

Currencies & Bonds

The Dollar Index was little-changed Tuesday (up 0.05%), and no major currency pair moved by more than 0.2%. Many global markets were closed Wednesday, and those that were open were operated by skeleton crews who just wanted to make sure there weren't any screw-ups.

The bond market, however, was more active. The 30-year yield dropped somewhat sharply on Christmas Eve, falling 0.6%, and the 10-year note dropped a more modest -0.35%, resulting in a steepening of the yield curve.

The negative catalysts were the strong Durable Goods and New Home Sales reports, which further imply the economy is continuing to pick up steam and the housing market, while it certainty has lost some momentum, was still healthy in October/November.

The 30-year bond is now creeping toward the early December lows of 128'01, while the 10-year yield is basically at the highs for the year (2.984%). It's only a matter of time before the lows in the 30-year and the highs in the 10-year yield are broken, and it'll be very important to watch how stocks act once we get a "3" handle on the 10-year yield. How the market reacts to a 3% 10-year yield will give us a lot of color on just how strong this rally still is.

Have a good day,

Tom

Market	Level	Change	% Change
Dollar Index	80.675	.001	0.0%
EUR/USD	1.3678	-.001	-.01%
GBP/USD	1.6361	-.0005	-.03%
USD/JPY	.009595	0.0	0.0%
USD/CAD	.9397	-.0006	-.06%
AUD/USD	.8881	.0003	.03%
USD/BRL	2.3625	.0052	.22%
10 Year Yield	2.98%	.054	1.84%
30 Year Yield	3.901%	.057	1.48%

Prices taken at previous day market close.

The 7:00's Report Asset Class Dashboard

(Outlook on the primary trend for major asset classes over the next month)

	Fundamental Outlook	Technical Outlook	Overall	Comments
Stocks	Neutral	Bullish	Bullish	*Stocks traded to new highs last week after the FOMC began tapering QE and 3Q GDP was stronger than expected. Skeptical sentiment towards the market and a strengthening economy remain tailwinds on the market, and as long as the short end of the yield curve remains anchored, the path of least resistance remains higher.* *Stocks are at all time highs, while first support site at 1813 in the S&P 500.*

Trade Ideas

Long Japan: **With Fed tapering expectations shifting to early 2014, the dollar should be supported over the coming months, which likely will result in the resumption of the decline in the yen. The yen has broken through 104 yen/dollar level, and DXJ is at multi-month highs. Although we could see a pause, that trend should continue over the coming months, and there remains more money in this trade.**

Long Deep, multi-national Cyclicals and Global Miners: **Domestically, I'd look to allocate to deep cyclicals like industrials (XLI), basic materials (IYM) and global industrial miners (PICK). It's a bit of a contrarian idea, and over the past few weeks these sectors have lagged. But, they most exposed to the "global economic recovery" thesis.**

Long Natural Gas E&Ps: **Term structure in the natural gas markets has turned bullish, as its in backwardation out nearly a year, implying a structural increase in demand. But, natural gas equities remain under pressure, and could potentially offer some value in the market over the medium/longer term. FCG and XOP are the two "pure play" ETFs in the natural gas E&P space.**

Commodities	Bullish	Neutral	Neutral	*The outlook for commodities remains mixed, as the global economy remains mired in stagnant growth. Given the severe underperformance of commodities this year, though, the asset class remains on of the last corners of value in the market, if the global recovery can accelerate.*

Trade Ideas

Long Industrial Commodities: **Industrial commodities have stalled lately, as economic data, especially in the US, has shown a loss of some positive momentum, and it bears close watching as to whether this is a temporary blip, or a bearish game changer. But, if you believe the global economy Is recovering, the commodity space, and the ETF DBC, is one of the best "values" in the market, and a pretty contrarian idea right now.**

Long Gold: **I'm dipping back into the well here with the gold trade. The near term outlook is mixed to negative, but medium term I think $1200 represents a fair risk/reward set up on an acceleration of inflation. I would initiate a small long position around the $1200 level with a stop at the old lows ($1179).**

U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index traded an outside reversal following the Fed decision to taper, and the multi-month downtrend in the Dollar Index is likely over.*

Trade Ideas

Short: **Japanese Yen. The yen has been supported mostly by extreme dollar weakness, and with tapering expectations being pulled forward, the yen should resume its decline vs. the dollar. YCS remains the best non-futures way to play the trade.**

Treasuries	Bearish	Bearish	Bearish	*With the Fed tapering QE and shift to "forward guidance" as the main policy tool, the case for the bond bears has gotten stronger. Continue to short any rallies in the bond*

Trade Ideas

Buy: **TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury). Finally, with the Fed committed to holding down near term rates, the yield curve will steepen dramatically, so STPP should continue to do well.**